and not to non-carriers.

The Joint Board's recommendation is quite clear that the Commission should adopt the statutory criteria contained in Section 214(e)(1) as the rules for determining whether a telecommunications carrier is eligible to receive universal service support. The Joint Board's position on additional criteria is not so clear, however. Although recommending that the Commission not impose eligibility criteria in addition to those contained in Section 214(e)(1) (Recommended Decision, para. 156), the Joint Board recommends that all eligible carriers be required to offer and provide LifeLine assistance to eligible low income customers. Recommended Decision, para. 417. (As noted earlier, SBC supports the latter recommendation.)

The Joint Board should have gone further in delineating additional criteria in order to ensure that those carriers receiving support actually extend quality, affordable universal service to all customers, and that the support is disbursed in a competitively neutral and non-discriminatory manner. The easiest way to accomplish those objectives would be to impose a similar level of regulatory obligation on all eligible carriers in those areas where support is required to ensure affordable service.[16] The Joint Board rejected that suggestion, without refuting the fact that symmetrical regulation prevents the selective targeting of only the lowest cost/highest revenue-producing customers in an area. Even if the Commission believes that symmetrical regulation should not or cannot be imposed, there is a set of minimum standards that should clearly be permitted, if not imposed.

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[16] Where support is not required, the marketplace and not regulation should be relied upon to ensure quality services at affordable prices.

The first universal service principle is that "[q]uality services should be available at just, reasonable, and affordable rates." Section 254(b)(1). Although Congress specifically mentions both quality services and affordable rates as universal service goals, the Joint Board failed to make any recommendations to ensure that eligible carriers actually provide quality service (i.e., abide by the same quality standards to which incumbent LECs are held), or to identify and measure affordable rates.

In its discussion regarding affordability, the Joint Board correctly concluded that the concept is comprised of two components: an absolute component (i.e., "to have enough or the means for") and a relative component (i.e., "to bear the costs of without serious detriment"). Recommended Decision, para. 125. The Joint Board is also correct that affordability relies on more than just a consideration of rate levels. Id., para. 130.

If the economically efficient price (i.e., the market price[17]) a company must charge exceeds the average customer's ability to pay, then the price should be considered "unaffordable" for universal service purposes. SBC believes that, based on an analysis of incumbent LEC actual costs, the market price in most areas would indeed be affordable for the majority of customers. In the remaining areas where the market price would otherwise be considered unaffordable, it is the role of universal service regulation to fund the difference between the market price and the constrained price for universal service and only to fund those carriers offering universal service at the constrained levels. LifeLine assistance would continue to ensure affordable service for lower income customers in all areas.

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[17] By market price, SBC means the price a company would realize in a naturally competitive environment to cover its costs and to make a reasonable contribution to joint and common costs.

The Commission should also promulgate rules that require all eligible carriers receiving support to meet certain, measurable quality standards as defined by the States. At the very least, the Commission should clearly determine that States, in their eligible carrier certification process, are free to adopt equitable, technologically-neutral, and non-discriminatory quality and affordability standards that must be met by the applying carrier.

Moreover, nowhere does the Joint Board confirm that high-cost support should be awarded to the carrier that bears the costs of actually investing in the network infrastructure used to provide universal service. Instead, the Joint Board recommends that universal service support shift to a new telephone exchange service provider ("local service provider" or "LSP") even when that LSP uses the incumbent LEC's loop and other facilities to actually serve the subscriber. Recommended Decision, para. 296. While the Joint Board recognized that Section 214(e)(1)(A) requires an eligible carrier to provide service through at least a combination of their own facilities and resale, the Board failed to foreclose situations where a carrier might attempt to meet that standard for an entire universal service area by making a minimal investment (for example, constructing a single loop to serve a customer located next door to the incumbent LEC's central office) and using resale to offer service to the rest of the area.

The Joint Board recognized that carriers offering universal service solely through reselling another carrier's services should not be eligible for universal service support. Recommended Decision, para. 161. This standard must be applied on a customer-by-customer basis. If a carrier is serving a customer through reselling another carrier's universal services, the carrier should not be eligible for support for that customer. In those situations, support should go to the carrier that owns and maintains the facilities used to provide universal service. An LSP is already able to purchase local exchange service from the incumbent LEC at a wholesale discount that the

Commission has set on an interim basis at between 17% and 25%[18] regardless of the fact that the service is being provided at a subsidized, below-cost rate. Not only does the LSP get the benefit of that "twice discounted" rate, avoid the investment risk associated with deploying network infrastructure in higher cost areas, and resell the incumbent LEC's service with little or no pricing constraints or other regulatory obligations imposed by regulators, the Joint Board would permit the reseller LSP to receive the universal service funding intended to help recover the high cost of the facilities used to serve that customer. The incumbent LEC, the entity that actually provides the facilities used, remains saddled with the unrecovered high costs and its "carrier of last resort" ("COLR") and "readiness to serve" ("RTS") obligations, while continuing to be required to maintain the very network used by the LSP's customer regardless of the economics. The result is that the incumbent LEC is forced to do everything it was doing before (and more),[19] while being denied support and receiving significantly less revenue in return. Adoption of such a structure would be unreasonable, arbitrary, and otherwise unlawful.

A support split would be necessary for unbundled network elements where appropriate. For example, if an eligible carrier is using unbundled elements at a combined rate of $30/month, the universal service benchmark is $25/month, and the cost of providing universal service is calculated to be $50/month, the rebundler should receive $5/month of the support with the remaining $20/month being paid to the provider of the unbundled network elements. Such a

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[18] Rule 51.611. The effectiveness of this Rule has been stayed on appeal (see n. 4 supra), but it has already had an effect on State arbitrations. For example, the Texas Public Utility Commission adopted in arbitration a wholesale discount of 21.64% for all retail services, including those that comprise "universal service."

Further, the Commission has already determined that even below-cost services must be resold at a discount by incumbent LECs. Interconnection Order, para. 956.

[19] The incumbent LEC incurs costs in performing wholesale activities, but the Commission's rules would not include those costs in the calculation of wholesale prices. See, generally, FCC Rules, Subpart G.

mechanism is especially needed due to the mismatch between the areas over which unbundled network elements will be deaveraged (e.g., the Commission required at least three per study area)[20] and the areas for which universal service cost calculations are made, as well as to account for any mismatch between Section 252(d) costs for unbundled elements and the costing methodology adopted for universal service calculations.

VI. ANY DETERMINATION OF SUPPORT MUST BE BASED ON ACTUAL COSTS

Generally speaking, support is required for areas where the actual costs associated with providing universal service cannot be recovered from the prices charged due to regulatory constraints and affordability considerations. Currently, incumbent LECs fulfill the role of universal service provider. To offset the losses that the incumbent LECs would otherwise experience in those areas, rates in other areas and for other services have been set higher than they otherwise would be. Through this system of implicit support, incumbent LECs have been given the opportunity to recover their actual costs of providing service and earn a fair return on "the full amount of their investment in depreciable assets devoted to public service." Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission, 485 F.2d 786, 808 (D.C.Cir. 1973). In fact, pervasively regulated incumbent LECs remain constitutionally entitled to a reasonable opportunity to recover their prudently incurred expenses and to earn a reasonable return on their prudent investments used in fulfilling their regulatory obligations. See Dusquesne Light Co. v. Barasch, 488 U.S. 299 (1989); FPC v. Hope Natural Gas Co, 320 U.S. 591 (1944). Absolutely nothing in the Act has changed or could have changed those constitutional standards, nor relieves the Commission or the States from meeting those requirements.

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[20] FCC Rule 51.507(f).

The Joint Board recommends the adoption of some as-yet-undefined "forward looking economic cost" proxy model[21] as a universal service cost standard, even though basing rates on actual costs has resulted in "just and reasonable rates" that have been acknowledged by the Joint Board to be "affordable." Recommended Decision, para. 133. There is nothing in the Act that requires or even suggests that Congress intended that the longstanding use of actual costs was to be jettisoned through Section 254. No reasonable explanation has been provided that justifies ignoring the actual costs of provisioning universal service, nor how the Joint Board envisions that the Commission or the State commissions will meet their constitutional obligations.

Moreover, the Joint Board's economic premise concerning the investment incentives associated with basing universal support on actual costs as opposed to forward-looking costs is flawed. Recommended Decision, paras. 275-76. The recommendation states that "[i]f support is based on embedded costs for the long-run, then incumbents and new entrants alike will receive incorrect signals about where they should invest. . . . [S]upport based on embedded costs could jeopardize the provision of universal service." Recommended Decision, para. 275. Only if the provision of universal services is generally an increasing cost industry could support linked to actual costs even potentially "jeopardize the provision of universal service." If the incremental costs of providing universal service were continuously rising over time, and actual costs were generally below incremental costs, then -- as the Recommended Decision points out -- support based on actual costs would be insufficient to recover the costs of either expanding existing networks or constructing new facilities.

The Commission must also consider the converse of this argument. If the telecommunications industry is generally characterized by declining costs, limiting universal

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[21] The Joint Board "cannot recommend that any of the proxy models submitted in this proceeding thus far . . . should be used to determine universal service support levels." Recommended Decision, para. 268.

service support to only forward-looking economic costs will discourage investment and facilities-based entry into local exchange markets. To the extent that incremental costs are declining over time, setting support at forward-looking economic costs will be insufficient to recover the current investment required for either incumbent LECs' networks or constructing entrants' new networks. Under this scenario, with support limited to forward-looking economic costs, the prospects of an attractive return on investing in new network construction at current cost levels would appear bleak indeed. It is unlikely potential entrants would perceive facilities-based entry into local exchange markets as a prudent investment if the profitability of such investment were precluded (or severely restricted) by support levels designed only to recover declining forward-looking economic costs.

Are forward-looking costs in telecommunications increasing? The Commission activity in LEC price cap reviews contradicts the premise. The Commission's acceptance of increasingly larger productivity offsets is consistent with the belief that telecommunications is generally a declining unit cost industry.[22] Continuously accelerating productivity growth and rising incremental costs typically would be incompatible economic phenomena. Thus, the Joint Board's recommendation to link support to forward-looking costs could well bring about the disinvestment scenario it is seeking to avoid. Alternatively, basing universal service support on embedded actual costs would ensure recovery of the total investment necessary to induce efficient facilities-based entry into local exchange markets in addition to permitting LECs the opportunity to recover investments incurred to achieve regulators' social policy goals.

Conceivably, where eligible carriers experience inevitable shortfalls because the support amount is too small, those revenue deficiencies may have to be recovered from customers in other

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[22] See *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, FCC-95-406, 10 FCC Rcd. 13659 (1995).

areas and of other services. In other words, the Joint Board seems to have prescribed a structure that will only replicate the system of implicit support that Congress sought to eliminate. And, given that incumbent LECs will most often experience those shortfalls, whether directly as undercompensated eligible carriers or indirectly as service- or facility-providers to resellers or rebundlers, their competitors will retain the competitive benefits of pricing under an inflated price umbrella for support-generating areas and customers. Such a process demonstrates the Joint Board's failure to design a plan which provides for predictable and sufficient support.

a. Proxy Models Must Replicate Actual Costs

The chart below is an extract of information from an ex parte filed by SBC on behalf of Southwestern Bell Telephone Company ("SWBT") on October 29, 1996 (see Attachment A),[23] which shows the results of a sensitivity analysis of the Hatfield Model. This analysis was conducted using SWBT information reconfigured to meet the parameters of the Hatfield input requirements, and shows that significantly different results are obtained from the Hatfield Model when more realistic input data is used. There are still likely to be differences because of the

[23] Ex Parte sent to Mr. James D. Schlicting, FCC, by Mr. Todd F. Silbergeld, SBC, on behalf of SWBT on October 29, 1996, Re: Federal State Joint Board on Universal Service, CC Docket No. 96-45; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98.

calculations used in the Hatfield Model, but using SWBT data certainly produces more believable results.

HATFIELD MODEL SENSITIVITY ANALYSIS
LOOP COST - SWBT MISSOURI

CHANGE	Individual Changes		Cumulative Change *	
	Loop Cost	Difference	Loop Cost	Cumulative Difference
Base Hatfield Run	$13.26	$0.00	$13.26	$0.00
1. Construction Cost Related	$16.26	$3.00	$16.26	$3.00
2. Mix of Cable Types	$12.70	($0.56)	$15.87	$2.61
3. Fiber crossover distance	$13.94	$0.68	$15.60	$2.34
4. Fill Factors	$15.05	$1.79	$15.89	$2.63
5. Corrected Cost of Capital	$13.79	$0.53	$16.64	$3.38
6. Corrected Depreciation Lives	$15.71	$2.45	$19.95	$6.69
7. Adjustments to ARMIS Input	$12.10	($1.16)	$19.50	$6.24
8. Loading Factor Corrections	$14.51	$1.25	$20.55	$7.29
9. % Structure Assigned to Telephone Correction	$16.57	$3.31	$28.09	$14.83

NOTES: * THE CUMULATIVE CHANGE **CANNOT** BE DETERMINED BY SUMMING THE AMOUNT OF CHANGE ASSOCIATED WITH INDIVIDUAL CHANGES DUE TO THE INTERACTIONS OF THE CHANGED VARIABLES.

A similar analysis has been conducted using Texas data for SWBT with the result shown below:

HATFIELD MODEL SENSITIVITY ANALYSIS
LOOP COST - SWBT TEXAS

CHANGE	Cumulative Change *	
	Loop Cost	Cumulative Difference
	$11.62	$0.00
1. Staff Changes	$17.41	$5.79
2. SWBT Depreciation/Capital Costs	$20.89	$9.27
3. SWBT Overhead Factor	$21.62	$10.00
4. SWBT Fill Factors	$22.07	$10.45
5. SWBT Structure Assign to Telephone	$23.82	$12.20
6. SWBT Cable Premise Term./SAI Costs	$24.68	$13.06
7. SWBT Switching Costs	$24.50	$12.88
8. SWBT Network Operations & CO Expense Factors	$25.12	$13.50
9. ARMIS Adjustments	$24.36	$12.74
10. SWBT Signaling Parameters	$24.34	$12.72
11. SWBT Miscellaneous Expense Factors	$23.95	$12.33
12. SWBT Wire Center parameters	$23.97	$12.35
13. SWBT IO and Tandem parameters	$23.64	$12.02
14. Miscellaneous Items	$23.28	$11.66
15. SWBT Cable Mix	$26.53	$14.92

NOTES: * THE CUMULATIVE CHANGE **CANNOT** BE DETERMINED BY SUMMING THE AMOUNT OF CHANGE ASSOCIATED WITH INDIVIDUAL CHANGES DUE TO THE INTERACTIONS OF THE CHANGED VARIABLES.

The details of the changes made can be found in Attachment B. This results of this Texas sensitivity analysis confirm the conclusion from Missouri sensitivity analysis that the Hatfield Model does not accurately represent the costs of providing the loop and that the existing model significantly understates the loop cost and therefore also understates the amount of support that would be required to maintain the level of universal service being provided today by SBC and the LEC industry.

While the Joint Board suggests rather broad criteria for adopting a cost proxy model, an additional criterion should be added to the list -- the model should be able to replicate the costs

experienced by incumbent LECs if the input variables reflect the equivalent values of those LECs. These costs should be used as a gauge to judge the reasonableness of the overall model and the ability of that model to provide for a fund that is "specific, predictable and sufficient." Unless the cost proxy model closely replicates the actual cost of providing universal service, the mechanism will not provide "specific, predictable and sufficient" support or "preserve and advance universal service."

b. There Is No Justification of Disparate Universal Service Cost Determinations Between Rural and Non-Rural LECs

The Recommended Decision provides for different treatment of rural and non-rural LECs. It does not, however, recognize that many of the LECs not classified as rural have significant "rural" characteristics. This can be shown with the Census data contained in the "Benchmark Cost Model 2" ("BCM2") for SWBT.

TOTAL HOUSEHOLDS BY DENSITY GROUP

	Density in HH/Sq. Mile					
	Less Than 5	5 to 200	200 to 650	650 to 850	850 to 2,550	Over 2,550
SWBT ARKANSAS	625	233,651	97,752	31,673	169,095	17,680
SWBT KANSAS	9,358	176,443	88,229	35,351	350,239	84,693
SWBT MISSOURI	291	260,488	214,774	71,332	567,133	300,516
SWBT OKLAHOMA	3,627	264,027	120,077	48,889	394,126	87,445
SWBT TEXAS	21,349	659,363	597,900	258,536	2,055,873	897,474

PERCENT OF TOTAL HOUSEHOLDS BY DENSITY GROUP

	Density in HH/Sq. Mile					
	Less Than 5	5 to 200	200 to 650	650 to 850	850 to 2,550	Over 2,550
SWBT ARKANSAS	0.1%	42.4%	17.8%	5.8%	30.7%	3.2%
SWBT KANSAS	1.3%	23.7%	11.9%	4.7%	47.1%	11.4%
SWBT MISSOURI	0.0%	18.4%	15.2%	5.0%	40.1%	21.2%
SWBT OKLAHOMA	0.4%	28.8%	13.1%	5.3%	42.9%	9.5%
SWBT TEXAS	0.5%	14.7%	13.3%	5.8%	45.8%	20.0%

This data demonstrates that a substantial number of households served by SWBT fall into density

groups that are similar to rural LECs. This fact can be demonstrated when an analysis is made of the area served, as shown below, based upon Census Block Groups ("CBGs"):

TOTAL AREA OF CBGs BY DENSITY GROUP

	Density in HH/Sq. Mile					
	Less Than 5	5 to 200	200 to 650	650 to 850	850 to 2,550	Over 2,550
SWBT ARKANSAS	177.7	6,975.3	288.1	44.1	128.9	6.1
SWBT KANSAS	4,064.6	5,099.9	246.5	50.3	243.7	28.0
SWBT MISSOURI	75.1	6,982.8	632.8	103.5	406.4	80.1
SWBT OKLAHOMA	1,232.9	8,552.5	354.2	68.6	284.0	28.7
SWBT TEXAS	12,162.6	18,084.3	1,725.2	370.8	1,434.5	252.2

PERCENT OF CBG AREA BY DENSITY GROUP

	Density in HH/Sq. Mile					
	Less Than 5	5 to 200	200 to 650	650 to 850	850 to 2,550	Over 2,550
SWBT ARKANSAS	2.3%	91.5%	3.8%	0.6%	1.7%	0.1%
SWBT KANSAS	41.8%	52.4%	2.5%	0.5%	2.5%	0.3%
SWBT MISSOURI	0.9%	84.3%	7.6%	1.2%	4.9%	1.0%
SWBT OKLAHOMA	11.7%	81.3%	3.4%	0.7%	2.7%	0.3%
SWBT TEXAS	35.7%	53.1%	5.1%	1.1%	4.2%	0.7%

This analysis clearly shows that a significant portion of SWBT's total service area is "rural" in nature for which greater support would otherwise be available but for the fact that SWBT is not a "rural" carrier.

In its recommendation, the Joint Board recommends disparate methods of calculating support in areas where rural LECs provide service as compared to areas served by "non-rural" LECs. The Joint Board's recommendation and its rationale for discriminating between non-rural LECs and LECs is unsupported, unreasonable and based upon irrelevant factors. In an apparent attempt to get around the fact that the only difference between the universal service cost calculation for two rural areas may be due to whether the serving incumbent LEC is a rural carrier, the Joint Board relies upon greater "economies of scale and scope" that non-rural LECs are assumed to have. In none of the various proposed forward-looking cost proxies does the size

of the eligible carrier or its economies of scale or scope affect the cost calculation of providing universal service, for obvious reasons. Why the Joint Board can then turn around and depend upon any such economies to distinguish treatment between existing carriers cannot be rationally and reasonably linked. Instead, the Joint Board seems to be reacting to a concern about the relative financial impact on rural LECs by shifting to a proxy method immediately, as compared to larger incumbent LECs. By doing so, the Joint Board seems to be either relying on the larger incumbent LECs' ability to absorb the financial impacts of this proceeding (as well as other outcomes of the Act), or expecting the larger incumbent LECs to be required to continue implicit support from its other customers. The first is absolutely irrelevant to the determination of universal service costs; the latter would violate the Congressionally established objective of eliminating implicit support.

In summation, providing less support to non-rural LECs than rural LECs in similarly situated circumstances would be inherently discriminatory and unlawful, and may disadvantage those customers living in rural areas served by non-rural LECs. The test for support should not rely on the status of the provider of service, rural or non-rural LECs, but on the costs incurred in, and the revenues received, from providing universal service in the area. The Commission should thus decline to bifurcate support calculations between "rural" and "non-rural" carriers, and at a minimum base universal service support on the actual cost of serving rural, high-cost customers.

c. The Commission Must Determine a Workable Definition of the Area Over Which Universal Service Costs Will Be Measured

While the Joint Board did not finalize a recommendation concerning the definition of the area for purposes of determining universal service costs, it did correctly specify that it could be smaller than the existing study area.[24] SBC continues to advocate the use of wire center areas as

[24] The areas over which universal service costs are determined do not need to be consistent with the designated service areas as established by the States.

the appropriate area for determination of such costs. There are a number of practical problems that exist for areas that are smaller than the existing wire center areas. First of all, customers can be readily associated with individual wire centers for purpose of reporting data for universal service. Not all customers can presently be mapped to CBGs. At the present time, for instance, using computer mapping techniques will only allow the accurate mapping of approximately 80% of SWBT's customers in Texas. The remaining 20% cannot be accurately mapped because the mapping software does not include the latest data in terms of street addresses (due for example to new street addresses being created as a result of new housing developments), some address information may not be sufficiently specific (e.g., rural routes or "box" addresses), or in terms of the location of the line not being specified.

In order to associate the remaining 20% of the lines, it might be necessary for someone to physically go to the customer's location with a global positioning system device, identify the position, record, and thereafter process that information. This process would have to be completed for approximately 1,600,000 access lines for SWBT's Texas operations alone.[25] SBC believes it is unlikely that smaller "rural" companies have the capability to even map 80% of their existing lines, so the burden to perform manual mapping would be even greater for them. The use of wire centers as the designation for universal service cost determinations would eliminate this needless expenditure. Needed line information is already available by wire center and would continue to be available in the future as business records are kept in the ordinary course of business.

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[25] Beyond the cost associated with personnel and equipment necessary to perform these activities, there would also be the costs of developing and implementing new support systems, or modifying existing systems, to manage and process the collected data. Each additional line added also would contribute to an ongoing cost to be incurred by each carrier for an activity otherwise wholly unnecessary. These would be additional costs added purely to satisfy regulatory requirements at a time when the Commission is eliminating reports and streamlining processes.

CBG boundaries are also not the same as the current serving areas of LECs, nor are they likely to be the same as the serving areas of new entrants. The illustrative map, attached as Attachment C, shows a typical wire center overlaid with CBG boundaries and the equivalent square area used to calculate the cost in the Benchmark Cost Model and Hatfield Models. As can be seen, the boundaries overlap and/or create voids when compared to each other. The BCM2 and Hatfield models calculate a theoretical cost for serving the equivalent square area of a CBG with the same centroid as the actual CBG. The table below summarizes the inconsistencies in the use of CBGs:

Assignment of CBG	Based on closest wire center
Model Computation of Costs	Equivalent square area of CBG
Assignment of lines	Telco serving area within CBG
Actual count of lines	Actual serving area boundary

Regarding the first item, in some cases the CBG is associated incorrectly with a wire center. On the attached map the CBG designated "483732103004" is associated with another wire center not belonging to SWBT. In other words, the costs calculated for this CBG will not be even theoretically computed on the existing wire center serving arrangement, in conflict with the generally stated intent of universal service. Secondly, using the equivalent square area of the CBG to compute these theoretical costs may be an expeditious way to do the mathematics, but since it appears that many of the CBGs are highly irregular in shape, it is questionable whether the computations really reflect even the stated hypothetical costs. Also, since the models are based on an assumption of an even distribution of households over the entire CBG and the actual distribution will be more random, another difference is built into this process.

All of these reasons support basing universal service cost calculations on the boundaries of the existing wire centers.

VII. THE JOINT BOARD'S RECOMMENDATION REGARDING A FEDERAL BENCHMARK PERPETUATES IMPLICIT SUPPORT AND IS UNNECESSARY

The Joint Board has recommended that the amount of support that a carrier receives from the federal universal service support mechanism would be based upon the difference between the cost of providing universal service and a benchmark amount. The Joint Board recommends use of a national revenue average which includes the revenues from services not contained in the definition of universal service. Including revenues from services other than those encompassed by the universal service definition perpetuates the reliance on implicit support to maintain universal service. Such action is in direct conflict with the intent of the Act, specifically Section 254(e). In fact, even the Joint Board admits that the implicit support provided from discretionary and access services are likely not sustainable in a competitive market.[26] Recommended Decision, para. 310.

Universal support can only be determined by comparing the actual costs of providing the service with the actual revenues received for those same services. The definition of universal service, however, is multi-jurisdictional in nature, including both *inter*state and *intra*state services. Therefore, commensurate with the Commission's jurisdictional authority over the interstate portion of the universal service definition, support based upon the total costs of providing universal service and the total revenues received for those same services must be jurisdictionalized into federal and state components. The total universal service support requirement should be jurisdictionalized via existing separations methods to determine the interstate universal service support funding requirement. The mechanism adopted by the Commission should be sufficient to address the existing interstate support flows (both explicit and implicit). The balance of the universal service support requirement would be allocated to the States for recovery via their

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[26] With the Commission preparing to institute and complete access reform by at least May 8, 1997 (maybe even before this proceeding is concluded) and given the recommended implementation date of the Recommended Decision, the Joint Board's use of an historical revenue average to calculate support is simply not reasonable.

specific intrastate universal service recovery mechanisms. This will ensure the Commission is operating within its jurisdictional authority to provide for the recovery of only interstate costs.

VIII. THE JOINT BOARD'S RECOMMENDATIONS WITH REGARD TO CARRIER COMMON LINE CHARGES ARE INAPPROPRIATE

First, the Joint Board recognized that Long Term Support ("LTS") is a support flow that should be made an explicit part of the new universal service support mechanism. However, the Joint Board's logic for splitting reductions associated with LTS removal between the CCL charge and the single-line Subscriber Line Charge ("SLC") reductions remains unclear and, more pointedly, would not accomplish the removal of LTS from the CCL charges. It is not apparent why the method of determining high-cost fund contribution -- whether or not to consider interstate as well as intrastate revenues -- should influence how the LTS cost removal is apportioned. LTS costs are currently recovered in their entirety in interstate CCL charges, despite those costs being unrelated to the access services of the charging LEC. It is appropriate to recover LTS costs from the universal service support mechanism, not from CCL.

However, the revenue basis adopted to determine each party's contribution to the fund is in no way related to how the cost removal is apportioned. The shift of LTS to the universal service fund should be fully realized in reductions to the interstate CCL where the LTS resides, no matter what the basis for contribution into the fund. Any other apportionment (e.g., equally between CCL and a lower SLC cap) would be arbitrary and unrelated to how the underlying costs are incurred. Moreover, it would wholly fail to accomplish the goal the Joint Board itself has established -- removal of LTS from interstate CCL charges. Whatever portion is used to reduce the SLC means that a portion of LTS remains within the CCL charge.

The Joint Board also notes that the Commission recently directed incumbent LECs to eliminate from their CCL charges an amount equal to the interstate allocation of pay telephone

costs. Recommended Decision, para. 773. The Joint Board incorrectly suggests applying the reduction in pay telephone costs to both the CCL and the SLC. This is inconceivable since the SLC is specifically determined in Part 69 without relation to any pay telephone costs.[27] The legitimacy of splitting CCL reductions associated with removing pay telephone support between CCL charges and a lower SLC cap is suspect. Pay telephone support was addressed in a separate proceeding (CC Docket 96-128), wherein the Commission ordered interstate pay telephone support removal be fully offset by reductions to the interstate CCL. The Joint Board has no jurisdiction over interstate cost recovery matters, and the Recommended Decision cannot conflict with an already final Commission order. Moreover, the SLC cap is based on each LEC's base factor portion (BFP), from which pay telephone costs are expressly excluded. Therefore, pay telephone support has no relation to the SLC cap and it would be arbitrary and capricious and otherwise unlawful to apportion half of the removal of pay telephone support to a reduction in the SLC cap.

Finally, at paragraph 771 of the Recommended Decision, the Joint Board acknowledges "the Commission must address the extent to which embedded loop costs should be recovered in its upcoming access charge reform proceeding." In the very next sentence, the Joint Board observes that "ultimately, the establishment of the SLC cap depends upon the Commission's resolution of each of these issues." These observations seem to conflict with the Joint Board's recommendation not to increase the SLC cap. If the high-cost fund size turns out to be insufficient to recover incumbent LEC actual common line costs adequately, the recommendation not to increase the SLC cap eliminates one feasible means of addressing common line cost under-recovery.

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[27] §69.501(d). Any portion of the Common Line element revenue requirement that is attributable to public telephone investment or expense shall be assigned to the Carrier Common Line element or elements.

IX. THE JOINT BOARD'S DEFINITION OF UNIVERSAL SERVICE WOULD BE A DRASTIC DEPARTURE FROM PREVIOUS PRACTICE AND ADMINISTRATIVELY DIFFICULT, IF NOT IMPOSSIBLE, TO IMPLEMENT

SBC is generally supportive of the services and functionalities that the Joint Board has recommended to be included in the definition of universal service. However, the Joint Board's recommendation that support for residential customers should be limited to a single connection to a subscriber's principal residence (Recommended Decision, para. 89) would be a drastic and unexplained departure from previous universal service policies, and would ignore incumbent LECs' continuing legal obligations. While limiting support to only primary residence lines would help to minimize the fund size, such a limitation would be unreasonable, and practically impossible to implement and administer effectively.

As an initial matter, there would always be the question of defining what is the "primary" residence. Whatever the definition, SBC does not today know when a location to which it provides local service is the primary residence of the subscriber, or whether the location is used as a vacation home. SBC expects that some number of customers may object to collection of such personal data, and that the accuracy of the information given will accordingly be suspect. The Recommended Decision also ignores that a primary residence of a person may change frequently (e.g., seasonally).

More fundamentally, a shift to supporting only primary residences would be a marked departure from historical and current universal service goals. Low-priced and readily available residential service has always been the primary universal service objective. Incumbent LECs thus have been and are now required to provide service to "second or vacation homes" at averaged prices set for the express purpose of achieving universal service goals (Recommended Decision, para. 90.), with Commission and State commissions' policies and rules currently structured to support that system (e.g., 47 C.F.R. Part 36 makes no such distinction). The Joint Board only

presumes that the "owner of these [second or vacation residences in high-cost areas] can afford to pay rates that accurately reflect the carrier's costs to provide services carried on connections to second residences." Recommended Decision, para. 90. While the presumption might have some validity, the members of the Joint Board know that incumbent LECs are not currently given the choice of either charging a compensatory price or denying telephone service. In essence then, if the Recommended Decision is implemented, incumbent LECs will retain their same COLR/RTS responsibilities for those "second or vacation" homes, and the Joint Board will have exacerbated the need for implicit support, not eliminated it, by ignoring those continuing obligations.

Moreover, the Recommended Decision ignores the many non-traditional living arrangements that exist today resulting in more than one line per residence. For example, due to housing costs or personal situations, adult children are remaining with or returning to their parents' homes. Their presence may require an additional line, whether in their own names or their parents. Many other situations where multiple adults are living in one dwelling and request multiple lines also occur. SBC has no way of knowing if a particular dwelling has been subdivided into separate apartments. The Joint Board's recommendation would nevertheless appear to only provide for support to one line, or turn on such niceties as whether service is in different customer names. Of course, the costs of serving those customers do not change, nor do the obligations of the incumbent LEC to provide service at a controlled price.

Without either providing sufficient support or removing current pricing constraints, incumbent LECs would be denied a reasonable opportunity to recover the costs of providing service and such action would certainly be confiscatory. If support is limited in accordance with the Recommended Decision, the Commission must preempt all pricing constraints on non-supported telephone exchange service unless upon implementation, the commission in a particular State has established an intrastate fund to support those federally unsupported services.

The Joint Board's recommendation that only one line per residential location be supported would be likewise difficult to implement, unreasonable and inconsistent with the principles behind Section 254. For example, the Joint Board's suggestion in paragraph 89 that carriers use subscriber billing information to determine the number of supported connections to a location is unworkable, and will become even more unworkable as the market becomes more competitive. To be in a position to ensure support was only provided for the initial connection to a subscriber's principal residence, the fund administrator would have to act as a clearinghouse and maintain a nationwide customer database, which would need to be continuously updated as customers make changes to their service or to their provider. Such an approach surely does not conform with Congress's deregulatory intent.

X. THE JOINT BOARD'S RECOMMENDATIONS ON DISCOUNTS FOR SCHOOLS AND LIBRARIES VIOLATE THE ACT AND EXCEED THE COMMISSION'S AUTHORITY

Beyond the questions posed in the Public Notice, SBC offers the following comments on the recommendations offered by the Joint Board. While the recommendations offered by the Joint Board are certainly positive for schools and libraries, implementation of the recommendations would violate the Act, exceed the Commission's authority, and otherwise be unlawful.

a. Pre-discount Price for Schools and Libraries

The Joint Board recommends use of a "request for proposals" ("RFP") process to establish a pre-discount price for schools and libraries. Such a recommendation could not be more inconsistent with previous Commission orders and State commission regulation, or more ironic in light of recent events. Incumbent LECs have historically been limited to providing services under publicly available tariffed rates that, again, reflect averaging for universal service purposes. Obviously, absent some ability to respond to an RFP for a tariffed service with a non-

tariffed rate, competitors of an incumbent LEC know exactly what the incumbent LEC will be required to bid as a matter of law. Secure in that knowledge, competitors can bid so as to ensure incumbent LECs win none of the profitable RFPs. The Joint Board's recommended action provides further evidence of the need for incumbent LECs to have the flexibility to respond to RFPs.

This state of affairs is not new. As the Commission is aware, SWBT filed a limited tariff revision with the Commission that would have permitted SWBT to respond to RFPs issued by prospective customers to avoid this result. The Commission flatly rejected SWBT's tariff revision. Although just last month remanded on appeal,[28] there is no indication that the Commission has changed its mind about the merits of an RFP tariff (and even if it does, when the Commission will act is uncertain).[29] Exactly how any incumbent LEC is supposed to respond competitively to an RFP issued by a school or library when the service is tariffed is not at all clear. Such a process obviously is not competitively neutral, violating one of the very standards that the Joint Board espouses.

Moreover, the Commission's resale rules can only exacerbate matters, as the Interconnection Order does not appear to have excluded individual case basis (ICB) offerings from the obligation to permit resale at a wholesale rate under Section 251(c)(4)(A). Unless the Commission specifically excludes any permitted responses to RFPs from the meaning of "at

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[28] Southwestern Bell Telephone Co. v. FCC, No. 95-1592 (D.C.Cir. November 26, 1996).

[29] For example, the remand proceeding required by Cincinnati Bell Telephone v. FCC, 69 F.3d 752 (6th Cir. 1995), a decision issued in late 1995, did not begin until August 13, 1996, and has set to be completed. See *Amendment to the Commission's Rules to Establish Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services*, WT Docket No. 96-162, Notice of Proposed Rulemaking, Order on Remand, and Waiver Order, FCC 96-319 (released August 13, 1996).

retail," it would presumably also be subject to the wholesale discount. Incumbent LECs would be left with little incentive or ability to provide service to schools or libraries. Congress never intended for either the Joint Board or the Commission to establish an RFP procedure that will effectively deny incumbent LECs the opportunity to provide telecommunications services to schools and libraries. By effectively excluding incumbent LECs from providing service to schools and libraries without any explanation whatsoever, the Joint Board has recommended an approach that is unreasonable, arbitrary, and otherwise unlawful.

Further, the recommendation to base discounts and reimbursements on a pre-discount price using the lowest corresponding price (LCP) concept violates the Act. Section 254(h)(1)(B) requires that the discount, which is the amount of price reduction necessary to make the price less than the price charged to other customers, is to be reimbursed from the universal service fund. This plainly means that the price a carrier would otherwise charge the school or library is the pre-discount price. There is no other reasonable interpretation. The effect of the Joint Board's recommendation appears to mandate an unfunded discount, which is in violation of the Act, in addition to the stated discounts which are reimbursed from the fund. The Commission has no authority under the Act to artificially lower the reimbursement level by implementing the recommended LCP concept.

Moreover, the LCP concept is not competitively neutral. For example, it is unclear what the geographic area over which the LCP applies is to include. If the LCP concept is implemented across a broad geographic area, where costs can vary significantly, then carriers are penalized for serving broad geographic areas. A carrier serving both low- and high-cost markets will be subject to reimbursement only to the price levels resulting from serving the low-cost markets. In that instance, the carrier will not be allowed to recover the costs incurred in serving the high-cost markets. Such an outcome is not competitively-neutral and, as with other Joint Board

recommendations, creates a need for the carrier to recover those costs from other customers. Such an outcome violates a fundamental principle of Section 254 which is to eliminate implicit support flows, not create new ones. The only way to legally implement a pre-discount price is to base the pre-discount price on the price that the carrier would charge absent the Act's mandated discount.

Even if the Commission decides to implement the LCP concept, then the Commission can only implement the LCP concept on interstate services. As explained below, the Commission has no authority over intrastate services and, therefore, has no authority to impose the LCP concept on intrastate discount reimbursements.

b. Only States Can Set the Intrastate Discount

The Joint Board overstepped its authority in contravention of Section 254 when it recommended that the Commission require State commissions to use the same discount schedule to schools and libraries for intrastate services as is used for interstate services. Recommended Decision, para. 573. Section 254(h)(1)(B) specifically states that "[t]he discount shall be an amount that the Commission, with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities." (emphasis added). A clearer delineation of authority is hard to imagine.

Under Section 254(h)(1)(B), a State is free to set discounts for intrastate services based upon its own determination of what is "appropriate and necessary," not based upon what the Commission believes is "appropriate and necessary" for each and every State without variation. Nor does Section 254(h)(1)(B) authorize the Joint Board or the Commission to condition support for those discounted intrastate services on adoption of the interstate discount schedule. In light of

the appeal of the Interconnection Order and the partial stay granted,[30] it is somewhat surprising that the Joint Board would attempt to intrude upon another prerogative specifically and expressly reserved to the States by Congress.

The fact that the Joint Board recommends that the Commission grant waivers of this requirement does not cure the jurisdictional intrusion upon a State's discretion to make these determinations on its own. A State need not attempt to satisfy the Commission's waiver standard[31] in order to exercise authority already solely and exclusively vested with that State by Congress.[32]

c. The Inclusion of Internet Access and Internal Connections Is Unlawful

The Commission should reject universal service funding for Internet access and internal connections as Section 254 only allows support for "telecommunications services" and funding to be received by either eligible carriers (under Section 254(e)) or carriers (under Section 254(h)). Inasmuch as Internet access and internal connections are not telecommunications services[33] and the Recommended Decision would permit non-carriers to receive funding,[34] the Commission cannot accept that recommendation. Moreover, as set forth herein, interpreting Section 254 to permit such funding would render Section 254(h) unconstitutional. The Commission should also reject the recommendation that "all" telecommunications services be eligible for a discount; such

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[30] See n. 4 supra.

[31] See FCC Rule 1.3.

[32] 47 U.S.C. 152(b); Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355 (1986).

[33] The Joint Board in fact concluded that Internet access is not a telecommunications service (Recommended Decision, para. 69), and never seriously contended that internal connections were. Id., para. 470-84.

[34] Recommended Decision, para. 484.